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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and Regulations involved	2
Statement	2
Summary of Argument	3
Argument:	
The rights to receive interest, rents, and dividends are rights of property constituting a part of the gross estate of the decedent at the date of his death and they must therefore be included within the gross estate under the optional valuation method	8
1. Applicable statute and Regulations	8
2. The basic issue	14
3. The right to interest is a property right within the meaning of Section 302 (j)	19
A. Coupon bonds	19
B. Other interest-bearing obligations	26
4. The right to rental payments under a lease is a property right within the meaning of Section 302 (j)	30
5. The right to dividends attaching to stock ownership is a property right within the meaning of Section 302 (j)	32
6. The Regulation is in accord with the Congressional purpose as shown by the legislative history of the statute	42
7. A provision of a tax statute granting a special privilege is to be strictly construed	50
8. The contentions advanced by petitioner in this case and by the petitioners in the *Abendroth* and *Blacque* cases do not establish the invalidity of the Regulation	52
A. The Regulation covers only the rights to interest, rents, dividends and royalties	52
B. No question of double taxation is involved	56
C. Only net income is used to measure the the value of decedent's income rights	58
D. The authorities relied upon by the taxpayers are distinguishable	59
Conclusion	63
Appendix	64

280610—41——1

CITATIONS

Cases:

	Page
Abendroth v. *Commissioner*, No. 510, present term	24, 40, 52, 56
Bank of Commerce v. *Tennessee*, 161 U. S. 134	36
Bettendorf v. *Commissioner*, 49 F. (2d) 173	34
Bijur v. *Standard Distilling Co.*, 74 N. Y. Eq. 546	34, 37
Blacque v. *Commissioner*, No. 511, present term	24, 40, 52, 56
Bonwit Teller & Co. v. *United States*, 283 U. S. 258	51
Brenner, Matter of, 169 N. Y. Misc., 412, affirmed per curiam, 256 N. Y. App. Div. 1064	34, 36
Brewster v. *Gage*, 280 U. S. 327	12, 13
Brown v. *Helvering*, 291 U. S. 193	50
Bull v. *United States*, 295 U. S. 247	56, 57, 59
Burnet v. *Houston*, 283 U. S. 223	15, 18, 35, 37
Burnet v. *Maiston* 57 F. (2d) 611	51
Chicago Theological Seminary v. *Illinois*, 188 U. S. 662	50
Commissioner v. *Manus-Muller & Co.*, 79 F. (2d) 19	50
Crimmins & Pierce Co. v. *Kidder, Peabody Accep. Corp.*, 282 Mass. 367; 185 N. E. 383	33
Deputy v. *DuPont*, 308 U. S. 488	50
Edwards v. *Bates County*, 163 U. S. 269	20
Fawcus Machine Co. v. *United States*, 282 U. S. 375	12, 13
Geiger v. *American Seeding Mach. Co.*, 124 Ohio St. 222; 177 N. E. 594	33
Guarantee Co. of North America v. *East Rome Township Co.*, 96 Ga. 511	35
Gude v. *Commissioner*, decided June 17, 1940 (B. T. A.)	59
Hawley v. *City of Malden*, 232 U. S. 1	36
Helvering v. *Bliss*, 293 U. S. 144	51
Helvering v. *Horst*, No. 27, present Term, decided November 25, 1940	20
Helvering v. *Inter-Mountain Life Ins. Co.*, 294 U. S. 686	50
Helvering v. *Northwest Steel Rolling Mills, Inc.*, No 121, present Term, decided November 12, 1940	50
Homestake Oil Co. v. *Rigler*, 39 F. (2d) 40	34
Intermountain Building & Loan Assn. v. *Gallegos*, 78 F. (2d) 972	34
Irwin v. *Gavit*, 268 U. S. 161	59, 62
Jermain v. *Lake Shore & Mich. So. Ry. Co.*, 91 N. Y. 483	33, 35
Kaufman v. *Charlottesville Woolen Mills*, 93 Va. 673	34
Kennedy v. *Central Power Co.*, 129 Neb. 637; 262 N. W. 504	33
Koshland v. *Helvering*, 298 U. S. 441	12, 59, 62
Lancaster Trust Co. v. *Mason*, 152 N. C. 660	34
Loomis, Matter of, 149 N. Y. Misc. 417	34, 37
Lynch v. *Hornby*, 247 U. S. 339	41, 59, 62
Mandel v. *North Hudson Inv. Co.*, 114 N. J. Eq. 336	35
Maryland Casualty Co. v. *United States*, 251 U. S. 342	12
Nelson v. *Ferguson*, 56 F. (2d) 121	35

Cases—Continued. Page

Nesbit v. *Riverside Independent District*, 144 U. S. 610 20
New Colonial Ice Co. v. *Helvering*, 292 U. S. 435 50
New Orleans v. *Houston*, 119 U. S. 265 36
Norwegian Nitrogen Co. v. *United States*, 288 U. S. 294 13
Onondaga Trust & Deposit Co. v. *Price*, 87 N. Y. 542 34
Samet v. *Farmers' & Merchants' Nat. Bank*, 247 Fed. 669 15
Segerstrom v. *Holland Piano Mfg. Co.*, 142 Minn. 104 34
S. Silberman & Sons v. *Commissioner*, 76 F. (2d) 360 40
State v. *First Bank Stock Corp.*, 197 Minn. 544; 267 N. W. 519 33
Townsend v. *Ashapoo Fertilizer Co.*, 212 Fed. 97 15
United States v. *Hermanos y Compania*, 209 U. S. 337 12
United States v. *Safe y Car Heating Co.*, 297 U. S. 88 ..... 18, 59, 60, 61, 62
United States v. *Stewart*, No. 13, present Term, decided November 12, 1940 50
United States v. *Supple Biddle Co.*, 265 U. S. 189 56
Van Allen v. *Assessors*, 3 Wall. 573 36
Voight v. *Remick*, 260 Mich. 198; 244 N. W. 446 33
Wallace's Estate, In re, — Ore. —; 282 Pac. 760 ..... 34, 35, 37
White v. *United States*, 305 U. S. 281 50

Statutes:

Revenue Act of 1926, c. 27, 44 Stat. 9:
Section 113 (a) (5) 18, 55
Section 302 (a) 64
Section 302 (c) 64
Section 302 (j) 2, 3, 4, 7, 8, 10, 12, 13, 14, 15, 16, 45, 50, 62, 64
Section 303 65
Revenue Act of 1935, c. 829, 49 Stat. 1041:
Section 202 (a) 2, 3, 8, 65

Miscellaneous:

75 Cong. Rec., Part —:
p. 7322 43
p. 11385 43
79 Cong. Rec., Part 13, p. 14,632 45
Fletcher, *Cyclopedia of Corporations*, Vol. 11, Sec. 5083 ..... 33, 34
Hearings before the House Committee on Ways and Means on Proposed Taxation of Individual and Corporate Incomes, Inheritances and Gifts, 74th Cong., 1st Sess., pp. 134–135, 136–138 ..... 42, 43, 45
Hearings before the Senate Finance Committee on H. R. 8974, 74th Cong., 1st Sess., pp. 204–207, 281, 282 ..... 42, 44, 45
Hohfeld, *Fundamental Legal Conceptions* (1923), p. 28 14
H. Rep. No. 708, 72d Cong., 1st Sess. 9, 42, 43, 45
H. Rep. No. 1492, 72d Cong., 1st Sess., p. 27 (Amendment No. 251) 43
H. Rep. No. 1651, 74th Cong., 1st Sess., pp. 1–4 49

Cases—Continued.

Page

H. Rep. No. 1681, 74th Cong., 1st Sess., p. 9 ..... 42, 45
H. Rep. 1885, 74th Cong., 1st Sess., pp. 10–11 ..... 16, 43, 47
H. Rep. 10236, 72d Cong., 1st Sess. (1932), Section 810 43
Paul & Mertens, *Law of Federal Income Taxation*, Vol. I, Sec. 3.30 51
S. Rep. No. 665, 72d Cong., 1st Sess., p. 54 43
S. Rep. No. 1240, 74th Cong., 1st Sess 42, 45, 47, 49
T. D. 4699, XV–2 Cum. Bull. 293, Article 13½, *Optional Valuation Date* 13
Treasury Regulations 80 (1937 Edition):
Article 11 ..... 3, 4, 10, 13, 66
Reports to the Joint Committee on Internal Revenue Taxation, Federal and State Death Taxes (1933), pp. 135, 137, 164–165, 254–255 ..... 42, 43, 45
Revenue Bill of 1935:
Section 204 (a) 44
Section 205 (a) (7) 44

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 274

HERBERT H. MAASS, AS SOLE SURVIVING EXECUTOR OF THE LAST WILL AND TESTAMENT OF IDA H. SAKS, DECEASED, PETITIONER

v.

JOSEPH T. HIGGINS, COLLECTOR OF INTERNAL REVENUE FOR THE THIRD DISTRICT OF NEW YORK

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the District Court (R. 17) is reported in 29 F. Supp. 996. The opinion of the Circuit Court of Appeals (R. 31) is reported in 111 F. (2d) 78.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 24, 1940 (R. 39). The petition for a writ of certiorari was filed July 23, 1940, and was granted October 14, 1940 (R. 42.) The

jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Section 302 (j) of the Revenue Act of 1926, as added by Section 202 (a) of the Revenue Act of 1935, gives the executor of an estate an option to have the value of the gross estate determined by valuing the property which is included therein on the date of decedent's death at its value as of the date one year after death; if any of the property is disposed of during the year after death, such property is to be valued at its value on the date of disposition. The question presented is whether rights to interest, rents, and dividends owned by a decedent at the date of his death are property of the estate within the meaning of this section.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and Regulations involved are set forth in the Appendix, *infra*, pp. 64–75.

STATEMENT

This case was decided by the District Court (R. 17–25) on motion by the taxpayers (R. 15), and cross motion by the Collector (R. 16), for judgment on the pleadings. The material facts, as alleged in the complaint (R. 4–7), may be summarized as follows:

Ida H. Saks, the decedent, a resident of the City of New York, died on August 30, 1936 (R. 4). In

the federal estate tax return filed on behalf of her estate, the executors exercised the option, provided by Section 302 (j) of the Revenue Act of 1926, as added by Section 202 (a) of the Revenue Act of 1935, to have the value of all the property included in the estate on the date of the decedent's death determined as of the optional valuation date provided in the statute (R. 5).

Pursuant to Article 11 of Treasury Regulations 80, the Commissioner of Internal Revenue included in the amount of the decedent's gross estate the sum of $19,956.32, representing interest, rents and dividends earned by and upon the property and assets of the estate subsequent to the date of death of the decedent (R. 5, 12). The federal estate tax which was thereafter assessed on this basis was duly paid, and claim for refund was filed and rejected; thereafter the present suit was instituted (R. 4–7).

The District Court decided that the amount in question was properly included in valuing the decedent's gross estate (R. 17–24); its judgment was affirmed by the court below (R. 39).

SUMMARY OF ARGUMENT

Under Section 302 (j) of the Revenue Act of 1926, executors have the option of computing the value of decedent's gross estate by valuing the property which is included therein on the date of decendent's death at its value as of the date one year after death; if any property is disposed of

during the year after death, such property is to be valued at its value on the date of disposition. The issue in this case is whether certain income rights owned by the decedent at the time of his death and disposed of during the year after death in return for interest, rents and dividends, are property rights within the meaning of this provision. The Treasury has determined that they are (Article 11, Regulations 80), and its determination must, of course, be given effect unless plainly in conflict with the statute.

In our view, the Treasury Regulations properly construe the Congressional intent. The property to be valued under Section 302 (j) is only that property which is included in the gross estate at the time of death; conversely, *all* the property which is included in the gross estate at the time of death must be included in the valuation as of a year after death. Since the basic purpose of the option is to achieve a valuation, a year after death, reflecting the then value of the same elements of value which would be included if the estate were valued as of the date of death, it seems clear that "property included in the gross estate," as used in Section 302 (j), includes every right which would enter into the valuation of the gross estate if valued at the time of death.

Since only that property is to be valued under the optional valuation method which decedent

owned at death, petitioner is clearly correct in his contention that income received by the estate during the year after death, which plainly did not belong to the decedent at the time of his death, is not to be included in the gross estate for purposes of optional valuation. The Government's position is not that such income should be included, but rather that any *income rights* which decedent owned at his death, and which would be reflected as an element of value in his gross estate if valued at the time of death, must likewise be reflected as an element of value in the gross estate, if valued as of the year after death. And since it is clear, upon analysis, that each of the income rights of which this decedent died the owner was an element of value entering into the value of her gross estate at the time of death, it follows that each of them must likewise be valued for purposes of optional valuation.

If we are correct in this position, then it is plain that such of the income rights as were disposed of during the year after death must be valued as of the date of their disposition, and that their value on that date may be measured by the amount received for them, namely, the amount of the interest, rents, and dividends. Similarly, where income has accrued but has not been collected during the year after death, the value of the income rights retained in the estate may be measured by the amount of income accrued.

280640—41——2

A contrary conclusion would result in many logically and economically baseless distinctions. It would mean, for example, that increases in the value of an estate due to accumulated corporate earnings, which are reflected in an increased value for the stock, would be included in the value of the gross estate, while increases in value due to distributed corporate earnings would be excluded. It would mean, similarly, that increases in the value of securities such as United States Savings Bonds would be included in the value of the gross estate, while increases in the value of comparable interest-bearing bonds would be excluded. And it would mean the inclusion in the value of the gross estate of income realized in the form of capital gains, but the exclusion of income realized in the form of interest, rents, and dividends.

Furthermore, acceptance of petitioner's position would allow executors in many cases to write a large part of their own tax bill by the simple device of selling the coupons attached to decedent's bonds, or making an assignment of rents due in the future under a lease, or causing a corporation in which the decedent owned stock to declare extraordinary dividends. If any of these things were done, the actual value of the estate would remain substantially unaffected, yet under petitioner's construction of the statute the taxable value of the estate would be greatly reduced. We believe it clear that Congress did not intend Section 302 (j) to be so construed.

The purpose of the section, as shown by its legislative history, was to alleviate the hardship presented when a decedent died in a time of rapidly falling markets and when, therefore, the value of the estate at the date of death was much greater than the value of the assets available for distribution at the end of the period of administration. At every stage of the legislative process, the emphasis was on the need for allowing the executor to value the estate at what it was actually worth when it became available for distribution rather than at the unrealizable values which existed only at the time of the decedent's death. The extent of the relief afforded by Section 302 (j) must be measured in terms of this need. Alleviation of the hardship obviously calls for no more than disregarding those values which, at the time of distribution, are no longer accessible; it neither requires nor justifies disregarding values which are in fact accessible. As the court below pointed out (R. 35), if executors "are not to be assessed upon what is practically beyond their reach, they should certainly be compelled to accept in its stead the total of what is practically within it."

It is significant that the enactment of the Revenue Act of 1935, which added the optional valuation provision to the estate tax law, was motivated by the need for greatly increased revenues, and that it provided for a very substantial increase in the estate-tax rates as well as for a reduction in the

amount of the specific exemption allowed. It is highly unreasonable to assume that in the same measure by which Congress sought to raise large additional sums for the federal Treasury, it also intended to grant to certain taxpayers a windfall of millions of dollars by giving them, in a relief provision, a tax reduction unrelated to the need sought to be relieved.

ARGUMENT

THE RIGHTS TO RECEIVE INTEREST, RENTS, AND DIVIDENDS ARE RIGHTS OF PROPERTY CONSTITUTING A PART OF THE GROSS ESTATE OF THE DECEDENT AT THE DATE OF HIS DEATH AND THEY MUST THEREFORE BE INCLUDED WITHIN THE GROSS ESTATE UNDER THE OPTIONAL VALUATION METHOD.

1. Applicable Statute and Regulations

Section 302 (j) of the Revenue Act of 1926, as added by Section 202 (a) of the Revenue Act of 1935, provides as follows:

> If the executor so elects upon his return * * *, the value of the gross estate shall be determined by valuing all the property included therein on the date of the decedent's death as of the date one year after the decedent's death, except that (1) property included in the gross estate on the date of death and, within one year after the decedent's death, distributed by the executor (or, in the case of property included in the gross estate under subdivision (c), (d), or (f) of this section, distributed by the trustee under

> the instrument of transfer); or sold, exchanged, or otherwise disposed of, shall be included at its value as of the time of such distribution, sale, exchange, or other disposition, whichever first occurs, instead of its value as of the date one year after the decedent's death * * *[1]

This section, as its legislative history shows (*infra*, pp. 42–45), was a by-product of the depression. It was intended to alleviate the hardship presented when a decedent died in a time of rapidly falling markets and when, therefore, the value of the estate at the date of death was much greater than the value of the assets at the end of the period of administration. In such a situation, an estate tax based upon values which existed only at the time of decedent's death might represent an undue proportion of the value of the assets actually avail-

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[1] The further provision of the statute that "any interest or estate which is affected by mere lapse of time shall be included at its value as of the time of death (instead of the later date) with adjustment for any difference in its value as of the later date not due to mere lapse of time" is not applicable to the situation here presented. The legislative history of the statute shows that this provision is confined in its application to patents, leaseholds, remainders, and other interests terminating upon the expiration of a period of time. See H. Rep. 708, 72d Cong., 1st Sess., p. 51, a report on a bill (enacted as the Revenue Act of 1932) containing a provision similar to Section 302 (j). Although this provision was not then enacted into law, it served as the basis for the subsequent enactment of Section 302 (j). The Committee reports on the 1935 Act throw no further light on the meaning of the "lapse of time" provision.

able for distribution. Accordingly, Congress gave executors the option of valuing the property included in the estate on the date of death, either as of the date of death or as of the date a year after death, the period of a year being considered the average time necessary for the administration of the estate.

The issue in this case is whether certain income rights owned by the decedent at the time of his death and disposed of during the year after death in return for interest, rents and dividends, are property rights within the meaning of Section 302 (j) which must be included in the gross estate under the optional valuation metho . Article 11 of Treasury Regulations 80 requires their inclusion and specifies at some length the reasons therefor:

> The property to be valued as of one year after the date of decedent's death, or as of date of decedent's death, or as of some intermediate date, is the property included in the gross estate on the date of the decedent's death. As property and its value are separate and distinct, the former denoting legal rights, the latter the monetary measure of such rights, and as subdivision (j) treats of the two separately, it will be necessary in every case first to determine what property constituted the gross estate at decedent's death. * * *
>
> Interest-bearing obligations, such as bonds and notes, embody two promises, one to pay principal and the other to pay inter-

est, and both promises are a part of the gross estate at the death of the decedent, if the obligation was then owned by him * * *. If the valuation date is that of decedent's death, the principal of the obligation and interest then accrued and unpaid thereon are to be valued as of that date. If the valuation date is subsequent to death, the principal and interest then accrued and unpaid are to be valued as of that date. The valuation date of any part payment of principal or of any installment of interest, made between decedent's death and the date as at which the obligation is to be valued, will be the date of such payment. Like rules will govern, so far as applicable, when any other obligation is involved, as, for example, one calling for the payment of rent or a royalty. Thus, in the case of rent, if the realty and the obligation to pay the rent reserved were parts of the gross estate at the time of decedent's death, the value of the former must be determined as of the applicable valuation date, and also the value of the rent then accrued and unpaid reserved by the latter. The valuation date of any rent paid in the interim pursuant to the rental obligation will be the date of its payment.

* * * * *

When corporate stock is a part of the gross estate at decedent's death, and a divi-

> dend in partial liquidation is thereafter paid on or before the date as of which the stock is to be valued, the valuation date of such dividend will be the date of its payment. Similarly, a dividend paid within the same period out of earnings, whether the earnings are made or accumulated prior or subsequent to decedent's death, will be valued as of the date of its payment. Earnings of the corporation neither declared as a dividend nor paid between decedent's death and the valuation date of the stock, will be reflected in the value of the stock. But a dividend declared prior to the valuation date of the stock and payable subsequent thereto will not be so reflected if the stock is selling "ex dividend" on such valuation date, but is to be valued as of that date.

The interpretation thus placed on Section 302 (j) by the agency charged with its administration must, of course, be given effect by the courts, unless the Regulation is plainly in conflict with the statute. *Koshland* v. *Helvering*, 298 U. S. 441, 446; *Brewster* v. *Gage*, 280 U. S. 327, 336; *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 349; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375; *United States* v. *Hermanos y Compañia*, 209 U. S. 337, 339. Petitioner's contention that the Regulation is "in essence a partisan argument" (Br. 38) reveals an astonishing misconception of the nature and function of regulations. The Treasury is charged by law with the duty of administering the Revenue Acts as enacted by Congress;

consequently, no considered interpretation of the Act by the Treasury can be treated as "partisan argument." To the contrary, every interpretative regulation expresses the best opinion of the tax experts of the Government as to the meaning of the statutory language employed by Congress; the opinion thus expressed is "entitled to respectful consideration, and will not be overruled except for weighty reasons." *Fawcus Machine Co.* v. *United States,* 282 U. S. 375, 378; *Brewster* v. *Gage,* 280 U. S. 327, 336. The fact that the Regulation is not of long standing is immaterial; an administrative ruling "has peculiar weight when it involves a contemporaneous construction of the statute by the men charged with the responsibility of setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet untried and new." *Norwegian Nitrogen Co.* v. *United States,* 288 U. S. 294, 315. In our view, the Regulation here involved, far from being clearly in conflict with the statute, expresses the evident intent of Congress.[2]

---

[2] Section 302 (j) became effective August 30, 1935. The provision of the present Article 11 of Regulations 80 was promulgated as "Article 13½, Optional valuation date" in T. D. 4699, XV–2 Cum. Bull. 293, and was approved September 25, 1936. The record does not show precisely when petitioner filed the estate tax return, but it must have been after promulgation of the Regulation, since decedent died on August 30, 1936 (R. 4). The return was probably not filed until on or around November 30, 1937, when the first payment of the tax was made (R. 5–6).

2. The Basic Issue

The fundamental question presented for determination is the meaning of the words "property included in the gross estate" as used in Section 302 (j). The statute does not define "property"; of gross estate, it says merely that the value of the gross estate shall be determined by including the value of "all property, real or personal, tangible or intangible" owned by the decedent at the time of his death (Sec. 302). The word "property" is, of course, one of many facets: in some connections it may be taken to mean simply the physical object to which various legal rights and privileges relate; in other connections, it may denote the aggregate of legal relations appertaining to a physical object. See Hohfeld, *Fundamental Legal Conceptions* (1923) 28. Its meaning in any particular connection must be ascertained by examination of the context in which it is found and, as used in a taxing statute, by analysis of the statutory scheme of taxation.

The scheme of taxation envisaged by Section 302 (j) is clear. The property to be valued as of the year after death is only that property which is included in the gross estate at the time of death; conversely, *all* the property which is included in the gross estate at the time of death must be included in the valuation as of a year after death. Since the basic purpose of the option is to achieve a valuation, a year after death, reflecting the then

value of the same elements of value which would be included if the estate were valued as of the date of death, we believe it apparent that "property included in the gross estate", as used in Section 302 (j), includes every right which would enter into the valuation of the gross estate if valued at the time of death. Cf. *Townsend* v. *Ashepoo Fertilizer Co.*, 212 Fed. 97, 101 (C. C. A. 4th), and *Samet* v. *Farmers' & Merchants' Nat. Bank*, 247 Fed. 669, 671 (C. C. A. 4th), both of which were cited with approval by this Court in *Burnet* v. *Houston*, 283 U. S. 223, 226–227. Under any other construction of the word "property", fewer elements of value would be appraised under the optional valuation method than were part of decedent's property at death; this would appear to be contrary to the plain intent of Congress to include in gross estate precisely the same elements of value under either method of valuation.

Since only that property is to be valued under the optional valuation method which decedent owned at death, petitioner is clearly correct in his contention that income received by the estate during the year after death, which plainly did not belong to the decedent at the time of this death, is not to be included in the gross estate for purposes of optional valuation. The Government has never contended that such income should be included in the gross estate. Its position is simply that any

income rights which decedent owned at his death, and which would be reflected as an element of value in his gross estate if valued at the time of death, must likewise be reflected as an element of value in the gross estate, if valued as of the year after death. And if, as in this case, one of those income rights (e. g., a coupon attached to a bond) is disposed of during the year after death, the value of the income right disposed of must be taken at its value on the date of disposition; that value will normally be the amount received in return for the income right—in the case of a coupon, the amount of interest paid.[3]

Petitioner misses the point completely in his discussion of the nature of capital and income (Br. 16–20). The Government recognizes, of course, that interest, rents, and dividends received by the estate during the year after death

[3] That the discharge of an obligation through payment at maturity constitutes a "disposition" of that obligation within the meaning of Section 302 (j) is plain. The Conference Committee report on the bill which became the Revenue Act of 1935 (H. Rep. 1885, 74th Cong., 1st Sess., pp. 10–11) gave an illustration of the manner in which Section 302 (j) was expected to operate. A hypothetical case was given in which a decedent died, owning, among other assets, foreign bonds of a face value of $10,000, but of a value as of the date of death of $9,550. Those bonds matured nine months after the date of death and were paid in full at maturity. The report states that under the optional valuation method, the foreign bonds should be reported as follows: "Foreign bonds (as of the date of disposition, i. e., maturity) . . . $10,000."

are income to the estate and, as such, may not be taxed as part of the gross estate; the Government urges merely that the income may be used as a measure of the value of the income rights owned by the decedent at the time of his death.

So far as the income rights themselves are concerned, it is not important that, from an income tax accounting point of view, they are not regarded as separable capital assets. Section 302 relates to "property," not to "capital," and income tax concepts of capital are therefore not relevant. There are many assets which a taxpayer may own which are not treated as his capital from an income tax accounting point of view and which yet are plainly his property; similarly there are assets which an executor may acquire from the decedent which are not treated as capital of the estate from an income tax standpoint and yet which, under the optional valuation method, must be treated as property of the decedent. To take a simple illustration, assume that a taxpayer purchases a share of stock for $100, that it increases in value to $150 by the time he dies, and that it is sold by his executor six months after his death for $200. From an income tax standpoint, the capital investment of the taxpayer in the stock is only $100, yet the stock must be included in gross estate, as his property, either at $150, if the estate is valued at the date of death, or at $200 if the optional valuation method is used. So far as the executor is concerned, his "capital"

for income tax purposes is $150 (Section 113 (a) (5)) and he therefore realizes taxable income when he sells the stock for $200. Yet, if the optional valuation method is used, the stock is includable in gross estate at $200. Plainly, therefore, the "property" to be included in gross estate under Section 302 is something different from the concept of "capital" employed in income tax accounting.

Another illustration which may be suggested is the case of a contested claim owned by the decedent at the time of his death. In *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, this Court held that such a claim is not "property that has been transmuted into capital" from an income tax standpoint. 297 U. S. at 97. Yet we believe it clear that, to the extent that the claim is an asset of value which is assignable for a valuable consideration, it is "property" includible in the gross estate under Section 302 (j). Cf. *Burnet* v. *Houston*, 283 U. S. 223, 226.

The basic issue here, therefore, is not whether the income rights are capital assets. Even though they are not capital assets from an income tax accounting point of view, if they are elements of value which enter into the valuation of the gross estate when valued at the time of death, they must also be considered part of the gross estate for purposes of optional valuation. In the succeeding sec-

tions of this brief we show that the right to interest (whether in the form of separate coupons or as an inseparable part of the obligation contained in a bond or note), the right to rental payments contained in a lease, and the right to dividends attaching to stock ownership, are income rights which are elements of value entering into the value of decedent's gross estate at the time of his death, and which must, therefore, likewise be valued for purposes of optional valuation. If we are correct in this position, then it is plain that such of the income rights as were disposed of during the year after death must be valued as of the date of their disposition, and that their value on that date may be measured by the amount received for them, namely, the amount of the interest, rents, and dividends. Similarly, when income has accrued but has not been collected during the year after death, the value of the income rights retained in the estate may be measured by the amount of income accrued.

3. The Right to Interest is a Property Right Within the Meaning of Section 302 (j)

A. *Coupon bonds.*—The validity of the Regulation may be most readily demonstrated by considering the rights owned by a decedent in a coupon bond. As this Court recently had occasion to observe, "The holder of a coupon bond is the owner of two independent and separable kinds of right. One is the right to demand and receive at maturity

the principal amount of the bond representing a capital investment. The other is the right to demand and receive interim payments of interest on the investment in the amounts and on the dates specified by the coupons." *Helvering* v. *Horst*, No. 27, present Term, decided November 25, 1940. Both majority and dissenting opinions in the *Horst* case recognize that the holder of a coupon bond, by the transfer of an unmatured coupon without consideration, makes a valuable gift; the making of such a gift, of course, implies the transfer of property or of a property right. This conclusion is implicit, too, in the earlier decision in *Nesbit* v. *Riverside Independent District*, 144 U. S. 610, 619, where the Court pointed out that "while the promises of the bond and of the coupons in the first instance are upon the same paper, and the coupons are for interest due upon the bond, yet the promise to pay the coupon is as distinct from that to pay the bond, as though the two promises were placed in different instruments, upon different paper." See also *Edwards* v. *Bates County*, 163 U. S. 269.

These decisions are but illustrations of what would in any event be clear, that an interest-bearing bond is simply a series of promises to pay installments of money in the future. All of the promises are separate obligations—so far separate that the obligee may bring successive actions upon them. *Nesbit* v. *Riverside Independent District supra; Edwards* v. *Bates County, supra.* In the

case of a coupon bond, each coupon is also separately negotiable for a valuable consideration, proving that, in and of itself, it is a valuable asset of the holder. It is immaterial that, for convenience, all the promises may be grouped together in a single piece of paper and may pass from hand to hand as such. The important fact, as the court below pointed out (R. 32), is that the value of the bond is the aggregate value of all the promises, both interest and principal, each promise being discounted for the interval before its performance is due, as well as for any doubts as to the obligor's responsibility. Since the value of the coupons is included in the value of the bond, it is clear that the income rights represented by the coupons are elements of value included in decedent's gross estate at his death and that they must, therefore, be included in his gross estate under the optional valuation method.

This may be graphically illustrated by assuming that a decedent dies on January 1, 1940, owning a $1,000 bond having a market value of $1,000 (exclusive of accrued interest), the bond being due in 1960, with interest payable at 5 percent semiannually on February 1 and August 1. It is perfectly plain that, on January 1, 1940, the obligation to pay the principal of $1,000 in 1960 is not worth $1,000; what makes the bond worth that amount is the obligation to pay interest periodically together with the obligation to pay the principal at ma-

turity.[4] If the February 1, 1940, coupon were missing from the bond, the bond would be worth less than $1,000 by an amount equal to the discounted value of the missing coupon. It is apparent, therefore, that the value of the bond—$1,000, plus accrued interest—which would have to be included in the value of the gross estate. if valued as of the date of death, includes the value of all the income rights attached to the bond, i. e., the coupons. And the fact that the value of the coupons would have to be included in the gross estate if valued as of the date of death demonstrates conclusively that the coupons are part of the "property" which decedent owned at death, within the meaning of Section 302.

If the optional valuation method is used, precisely the same property must be included in the value of the gross estate. On January 1, 1940, the February 1 and August 1 coupons were income rights owned by the decedent which were of value and which were part of the value of his gross estate. During the year, those income rights were disposed of in return for interest, their value at the date of disposition being the amount of interest received. To exclude from gross estate for purposes of optional valuation the value of those

[4] This is strikingly illustrated by the provision commonly found in corporate bonds giving the company a right to redeem the bonds *at a premium* prior to maturity. The premium is simply consideration for the cancellation of the company's obligation to pay interest to maturity.

rights on the date of their disposition would be to include fewer elements of value, i. e., less property, in gross estate under the optional valuation method than would have been included if the gross estate had been valued as of the date of death. This would be in plain violation of the statutory mandate that the same elements of value be included under either method of valuation.

The result is the same if the executors, instead of presenting the February 1 and August 1, 1940, coupons, placed the bond, with all coupons attached, in a safe deposit box and did not touch it until a year after death. All the property rights in the bond of which decedent died the owner are, of course, represented by the piece of paper placed in the box. A year later, assuming a constant market, that same piece of paper would have increased in value by the amount of the interest coupons which had matured. Since the piece of paper represents the same property rights a year after death as it represented at the time of death, and since the piece of paper has increased in value, it is evident that there has been an increase in the value of the property rights owned by the decedent at the time of his death.

The same conclusion is reached if we approach the question by examining the situation of a decedent who dies owning merely an unmatured coupon which the holder of a bond had previously transferred to him. Plainly that coupon would

be property of the decedent and would have to be included in the value of his gross estate, whether valued as of the date of death or under the optional valuation method. If the latter method is adopted and the coupon matures and is presented for payment during the year after death, the coupon would obviously have to be included in the gross estate at its value on the date of its disposition, which would be the amount of the payment received. It can, of course, make no difference in interpreting the word "property", as used in Section 302 (j), whether the coupon is owned by the holder of the bond or by another; if it is "property" in the one case, it must be "property" in the other.

The conclusion is inescapable, therefore, that the income right represented by a coupon of which a decedent dies the owner is a property right and that, as such, its value must be included in decedent's gross estate whichever method of valuation is used.

The petitioners in *Abendroth* v. *Commissioner* and *Blacque* v. *Commissioner*, Nos. 510 and 511, present Term—cases which involve precisely the same issue as this case and which are to be argued together with this case—in effect admit the validity of our position by stating (Br. 40–41):

> It is said that the executor may sell all the coupons from the estate's bonds, so that one year after death the bonds will have lost a great part of their value, and that an un-

> fair advantage would be obtained by the estate if the proceeds were not added to the estate in arriving at the value one year after death. The answer is obvious. *Selling off coupons in advance of their maturity would materially alter the bonds; the mutilated bonds left in the estate would not be the same assets as the bonds owned at the date of death with all unmatured coupons attached.* For example, they would not be good delivery against a contract to sell the original bonds. *It seems clear that the original bonds would have to be valued at the date of such mutilation.* [Italics supplied.]

They then attempt to draw a distinction between such a case and the collection of coupons "in regular course as they mature" by alleging that, in the latter situation, the bond "remains what it always was, a bond with all unmatured coupons attached" (Br. 41).

The admission that selling the coupons in advance of their maturity would "materially alter the bonds" and that the bonds without the coupons "would not be the same assets as the bonds owned at the date of death" recognizes, of course, that the bondholders' right to interest, represented by the coupons, is an element of value which is an essential part of his property and the value of which is reflected in the value of his property. If, in the case of a sale of the coupons, the bond would have to be valued at the date of such sale, as these petitioners suggest, it must only be because the sale

constitutes a partial disposition of the decedent's property.

For purposes of determining the property rights which decedent owned at his death, it seems to us immaterial whether the executor disposes of all the coupons attached to a bond or of only those coupons which mature. If all the unmatured coupons together are property of the decedent at his death, as these petitioners in effect admit, then each unmatured coupon must likewise be his property. And if an unmatured coupon is property, it is not the less property when it matures and is disposed of in return for an interest payment.

The fact, stressed by these petitioners, that after the disposition of the matured coupon the bond still has all the unmatured coupons attached is immaterial; the property of the decedent at his death, which is the property to be valued, is the bond with all of the *then* unmatured coupons attached. This, of course, includes all coupons which mature during the year after death.

B. *Other interest-bearing obligations.*—Coupon bonds have been separately treated only because they present the most graphic demonstration of the validity of the Regulation; it is evident, however, that the same principles which govern the case of coupon bonds are likewise applicable to the case of other interest-bearing obligations. Whether the provision for interest is contained in coupons attached to the bond or is embodied in the bond

itself, it is still true that the bond is simply a series of promises to pay installments of money in the future and that the promises are separate obligations, on which the obligee may bring successive actions. In the case of the coupon bond, the promise to pay interest is in the form of a negotiable instrument; although this is not true of other types of obligations, the promise to pay interest contained in such obligations is nonetheless separately assignable for a valuable consideration, proving that, in and of itself, it is a valuable asset.

As in the case of coupon bonds, the promise to pay interest contained in all interest-bearing obligations is an element of value which is included in the value of the obligation at the decedent's death. A $1,000 note, payable in 20 years, is worth $1,000 at the decedent's death only because of the promise it contains to pay interest during the period before maturity. Since the note would have to be included in decedent's gross estate, if valued at the time of his death, at $1,000, it is plain that the value of the gross estate at the time of death includes the value of the income right. This being true, it follows that the income right must likewise be included in the gross estate under the optional valuation method, and, if there is a partial disposition of the income right during the year after death through the receipt of interest, the value of the right disposed of must be included at its value on the date of disposition. This value,

of course, may be measured by the amount of interest received.

As in the case of coupon bonds, if a noncoupon bond owned by a decedent is left untouched in a safe-deposit box for the year after death, the same piece of paper placed in the box would be worth more at the end of the year than it was worth at the time of the decedent's death by the amount of interest due thereon, assuming a constant market. Since all the property rights owned by the decedent in the bond at the time of his death are evidenced by the piece of paper and since the same piece of paper is worth more at the end of the year, it is apparent that the property rights in the estate at the time of death have increased in value by the amount of the interest accrued.

It is pertinent to inquire how petitioner would reconcile his position that income rights on bonds should not be included in gross estate for purposes of optional valuation with the treatment necessarily accorded under the statute to the enhancement in value of United States Savings Bonds. These Savings Bonds, as the Court knows, do not carry a promise to pay interest, but instead provide for an increased cash surrender value at the end of each year and for the payment at the end of ten years of an amount which is larger by one-third than the amount paid for the bonds upon their issuance. It is obvious that if the decedent owned a Savings Bond at the time of his death, the increase in the value of

that bond during the year after death would be reflected in the value of the decedent's gross estate under the optional valuation method. Yet that increase in value is, of course, simply the economic counterpart of accrued interest.[5] Thus, petitioner's theory would free from estate taxation an increase in value of the estate due to interest paid, while subjecting to estate taxation an increase in value due to interest accrued. A distinction so logically and economically baseless should certainly not be read into the statute unless the statutory language expressly requires it.

To hold that the income right represented by the obligation to pay interest on a bond is not to be included in gross estate for purposes of optional valuation would be to open a wide door to tax avoidance. The executor of an estate which includes, for example, an interest-bearing note with a three-year maturity might very easily be able to bargain with the obligor for an advance payment of interest for the entire remaining period, in return for the granting of a discount. If this were done, the obligation, as of a year from the date of death, would be of substantially less value than it was at the date of death, even though the value of the promise to pay the principal at maturity remained constant. Thus, petitioner's interpretation of Section 302 (j)

[5] If a Savings Bond is held until maturity, the increase on the original investment is equivalent to annual interest of 2.9% compounded semiannually.

would permit use of the optional valuation method, not only to reflect a shrinkage in value of assets due to a market decline, but also entirely to avoid estate taxation on elements of value which were part of decedent's gross estate at the time of his death. It is evident, we believe, that Congress had no such intent.

4. The Right to Rental Payments Under a Lease is a Property Right Within the Meaning of Section 302 (j)

The record is silent as to the nature of the property owned by the decedent on which the estate received rents during the year after death; in the absence of other proof, the assumption may properly be made that at the time of his death decedent owned real estate subject to a lease for a period of years, the lease providing for stipulated yearly rental payments. The right to those rental payments is, we believe, a property right owned by the decedent at the time of his death, which would be included in the value of his gross estate if valued at the time of death, and which must, therefore, be included in gross estate under the optional valuation method. If this be so, the income right disposed of during the year after death in return for the rental payment must be included in gross estate at its value on the date of disposition, which would be measured by the amount of rent received.

If a decedent dies owning real property subject to a lease, he obviously owns more than an estate in reversion; he owns in addition a valuable contract

right, his interest in the lease. That interest is a valuable asset, its value to the decedent normally being the value of the obligation to pay rent. The amount of rent provided for in the lease, i. e., the value of the income rights owned by the lessor, clearly affects the value of decedent's estate; if the lease is favorable, it increases the value of the estate, while if unfavorable the value of the estate decreases. It follows that the value of the property rights owned by decedent is dependent both upon the value of the income rights during the term of the lease and upon the estimated value of the land at the termination of the lease. The income rights under the lease are, of course, assignable for a valuable consideration, proving that in and of themselves they are a valuable asset; if there has been such an assignment of rents, the value of the property retained by decedent at the time of his death is obviously only the value of the reversionary estate.

It is evident, therefore, that in every case where a decedent owns real property subject to a lease and has made no assignment of rents, the value of the property which must be included in gross estate, if valued as of the date of death, includes the value of the income rights under the lease. Those income rights are consequently property rights within the meaning of Section 302 and their value must also be included under the optional valuation method. As of a year after death, there has been

a partial disposition of those property rights through the receipt of rent; if the value of the gross estate is computed without reference to the value of the rights disposed of, fewer elements of value would be included in the gross estate under the optional valuation method than would be included if the estate were valued as of the date of death, in plain violation of the statute.

Adoption of petitioner's theory would provide a facile method of tax avoidance in the case of rents as in the case of bonds. The executor might easily be able to arrange to have the lessee pay the rent for a number of years in advance in return for a discount, or he might make an assignment of those rents for a valuable consideration. The actual value of the estate would not be materially affected by this action, yet petitioner would have the Court hold that the value of the estate subject to taxation was affected. An interpretation of the statute which leads to such a result should plainly be avoided.

5. The Right to Dividends Attaching to Stock Ownership is a Property Right Within the Meaning of Section 302 (j)

As the court below recognized (R. 33), the right to dividends raises a somewhat more difficult question than the rights to interest and rent discussed above. Unlike a bondholder or lessor, a stockholder does not own an obligation providing for fixed payments to him at designated intervals; a definite obligation to pay dividends arises only

after the dividend has been declared by the Board of Directors of the corporation. But, in our view, this difference is not material. The determinative fact is that when a decedent dies owning stock, he owns a right to dividends, as and when declared, which, although not a chose in action, is nonetheless an element of value which affects and enters into the value of the stock and which would, therefore, be included in the value of the gross estate if valued as of the date of death. Consequently, it is a property right within the meaning of Section 302 (j) and must be included in the value of gross estate under the optional valuation method. This being true, any dividends received during the year after death may, of course, be used as a measure of the value of the dividend right owned by the decedent.

The relation between a corporation and its stockholders is contractual in nature. See Fletcher, Cyclopedia of Corporations, Vol. 11, Sec. 5083 and cases cited; *Jermain* v. *Lake Shore & Mich. So. Ry. Co.,* 91 N. Y. 483–494; *Geiger* v. *American Seeding Mach. Co.,* 124 Ohio St. 222, 177 N. E. 594, 599; *Crimmins & Peirce Co.* v. *Kidder, Peabody Accept. Corp.,* 292 Mass. 367, 375; 185 N. E. 383, 386; *State* v. *First Bank Stock Corp.,* 197 Minn. 544, 547, 267 N. W. 519, 521; *Voight* v. *Remick,* 260 Mich. 198, 204, 244 N. W. 446, 449; *Kennedy* v. *Central Power Co.,* 129 Neb. 637, 262 N. W. 504. By virtue of this contractual relation, the stock-

holder enjoys several rights, the aggregate value of which represents the value of the stock; the principal rights enjoyed are the right to participate in the surplus profits of the corporation on their division and, on the dissolution of the corporation, to participate in the assets remaining after the payment of the corporation's debts. See Fletcher, *supra*, and cases cited; see also *In re Wallace's Estate*, 131 Ore. 597, 282 Pac. 760, 761; *Bijur* v. *Standard Distilling Co.*, 74 N. J. Eq. 546, 556–557; *Intermountain Building & Loan Ass'n* v. *Gallegos*, 78 F. (2d) 972 (C. C. A. 9th). The right to participate in the surplus profits of the corporation, i. e., the right to dividends, is plainly a valuable asset of the stockholder. Indeed, in the normal case, the existence of the right to dividends is the motivating force for the investment in the stock, and the market value of the stock depends in large part upon the estimated value of the dividend right. If the stockholder assigns to another his right to dividends for a specified period[6] the value of his remaining interest in the

[6] That the right to dividends is separately assignable is established. *Homestake Oil Co.* v. *Rigler*, 39 F. (2d) 40 (C. C. A. 9th); *Bettendorf* v. *Commissioner*, 49 F. (2d) 173 (C. C. A. 8th); *Onondaga Trust & Deposit Co.* v. *Price*, 87 N. Y. 542, 547, 549; *Segerstrom* v. *Holland Piano Mfg. Co.*, 142 Minn. 104, 105; *Matter of Brenner*, 169 N. Y. Misc. 412, affirmed per curiam, 256 N. Y. App. Div. 1064; *Kaufman* v. *Charlottesville Woolen Mills*, 93 Va. 673; *Lancaster Trust Co.* v. *Mason*, 152 N. C. 660; *Matter of Loomis*, 149 N. Y.

stock would be materially decreased, proving that the right in and of itself is an element of value. Cf. *In re Wallace's Estate, supra.* And certainly no one would deny that the assignee of the right is the owner of a valuable asset.

The fact that, before the declaration of the dividend, the dividend right is not a chose in action and the amount of the dividend to be paid is uncertain is not material. It is true that this fact may affect the value of the right; as in the case of any right the enjoyment of which is dependent on a condition precedent, the value of the dividend right depends upon the likelihood of the condition precedent occurring as well as upon the amount to be received if the condition precedent does occur. The existence of the condition precedent, however, does not deprive the right of its character as an asset; the stockholder still enjoys the right to the dividend as and when declared. See e. g., *Jermain* v. *Lake Shore & Mich., So. Ry. Co., supra,* at 494; cf. *Burnet* v. *Houston,* 283 U. S. 223, 226; *Nelson* v. *Ferguson,* 56 F. (2d) 121, 124 (C. C. A. 3d).

Petitioner's argument with respect to dividends is based on the premise that a stockholder has no present right in the future earnings of the corporation. This premise is no doubt true, just as it

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Misc. 417, 421; cf. *Mandel* v. *North Hudson Inv. Co.,* 114 N. J. Eq. 336; *Guarantee Co. of North America* v. *East Rome Town Co.,* 96 Ga. 511.

is also true that the stockholder has no present right in the accumulated earnings of the corporation or in the capital assets of the corporation.[7] But that is beside the point. Ownership of stock, which is admittedly property, never carrys with it ownership of the corporate property or income; as pointed out in a searching opinion by Surrogate Delehanty analyzing the nature of stock (*Matter of Brenner,* 169 N. Y. Misc. 412, 416, 417, affirmed per curiam, 256 N. Y. App. Div. 1064), the property of the stockholder consists merely of "a collection of rights which he has toward certain earnings and capital *all* of which is owned by the corporation. Not only does the corporation own its earnings before declaration of a dividend but it also owns the capital." It is, therefore, fallacious to consider "that as to the corporate capital symbolized by a share of stock the holder has a more direct ownership than he enjoys in respect to individual profits" (*id.*).

As this opinion shows, the "property" represented by a share of stock is not a property right in corporate assets or earnings; it is rather in the nature of a contractual right of participation in profits and capital upon distribution. The right

[7] It is, of course, elementary that the property of the shareholders in their respective shares is distinct from the corporate property. *Van Allen* v. *Assessors*, 3 Wall. 573, 584; *New Orleans* v. *Houston*, 119 U. S. 265, 277; *Bank of Commerce* v. *Tennessee*, 161 U. S. 134, 146; *Hawley* v. *City of Malden*, 232 U. S. 1, 9.

to participate in the distribution of profits, i. e., the right to dividends, is of precisely the same nature as the right to participate in the distribution of capital.[8] If one is property, the other must also be property. And if, as is admitted, both rights together are property, then each constituent right must also be considered as a property right. See, e. g., *Bijur* v. *Standard Distilling Co.*, 74 N. Y. Eq. 546, 556–557; *Matter of Loomis*, 149 N. Y. Misc. 417, 421; cf. *Burnet* v. *Houston, supra; In re Wallace's Estate, supra.*

The point may be illustrated by assuming that at decedent's death he owns stock in the X corporation, having a market value of $100 per share. The X corporation has $100,000 capital and $100,000 earned surplus, of which $50,000 is available for distribution and is actually distributed during the year after decedent's death. It is apparent that, at decedent's death, the market value of the stock, $100 per share, reflects the value of the stockholder's right to participate, whether through dividend payments or on dissolution, in both the capital and surplus of the corporation, as well as the market's appraisal of the future prospects of the company. After the $50,000 dividend payment is made, the value of the stockholder's right to participate is

[8] This is perhaps most graphically illustrated by the case of a corporation owning wasting assets where each dividend represents a distribution of both capital and profits and where there are generally no assets remaining for distribution upon dissolution.

pro tanto reduced. To value the stock as of the year after death without including the dividend payment would, therefore, be to include fewer elements of value under the optional valuation method than would have been included if the estate had been valued as of the date of death. We believe it evident that Congress did not intend Section 302 (j) to be so applied and yet, if petitioner's construction of the statute be accepted, every dividend paid during the year after death, even though from earnings accumulated prior to the date of death, would be excluded from the measure of the value of the gross estate.

The conclusion flowing from the foregoing analysis that the right to dividends is a property right owned by the decedent which must be valued under the optional valuation method is also supported by various practical considerations. It is not disputed that if the corporation earns net profits during the year after death which it does not distribute, the increase in the value of the stock due to those earnings would be included in the gross estate under the optional valuation method. Petitioner's theory, therefore, assumes that Congress intended the amount of the tax on the estate to be dependent upon whether the corporation does or does not distribute its earnings. This, of course, is completely illogical. The value of the assets in the estate is the same whether the earnings of the corporation are accumulated or distributed and

the amount of the tax on the estate should, therefore, be the same in either case.

If the corporation sustains a loss during the year after death, the value of the stock would shrink and the tax liability of the estate would be proportionately less. If, on the other hand, the corporation makes a profit which it retains, the value of the stock would increase and the tax liability of the estate would be proportionately greater. There is no reason in principle why a different result should be reached if the increase in the value of the estate is represented by dividend payments rather than by an increase in the value of the stock; in both situations, it is the profits of the corporation which increase the value of the estate by virtue of the property rights of which the decedent died the owner, and the tax liability in both situations should, therefore, be the same.

Again, if the executor distributed the stock to the beneficiaries, or sold it, during the year after death, the amount of the estate's tax liability would, under petitioner's theory, be affected by the date of distribution or sale. If that date were just prior to the declaration or record date of a dividend payment, the value of the stock distributed or sold would include the value of the dividend and that value would, therefore, be included in the gross estate. If, on the other hand, the stock were distributed or sold a few days later *ex dividend*, petitioner's theory would require the

exclusion of the value of the dividend from the value of the gross estate, even though the actual value of the estate would be the same in both situations. We submit that a construction of the statute resulting in such a baseless distinction does not properly reflect the Congressional purpose.

Moreover, adoption of the petitioner's theory would, in many cases, allow the executor to write a large part of his own tax bill. It is common knowledge that the fortunes of many wealthy individuals are lodged in personal holding companies. The executor of the estate of such an individual could very substantially reduce the value of the stock of the personal holding company by the simple expedient of having the company distribute extraordinary dividends during the year after death. This would not, of course, affect the actual value of the estate at all, and yet, under petitioner's theory, the executor would have succeeded in eliminating from taxation the entire value of the dividend, which might, in some cases, represent a very substantial part of the decedent's wealth. Cf. *S. Silberman & Sons* v. *Commissioner*, 76 F. (2d) 360 (C. C. A. 7th).[9]

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[9] Petitioners in the *Abendroth* and *Blacque* cases (Nos. 510 and 511, present Term) attempt to avoid the force of this position by the suggestion that a distinction should be drawn between ordinary and extraordinary dividends and that, in the case of an extraordinary dividend, the stock should be included in gross estate at its value before the payment of the dividend (Br. 41–42). The suggested distinction, however, finds no support in any express provision of the statute

It is true that the court below did express some doubt as to the propriety of considering the right to dividends as a property right because of the absence of any fixed obligation on the part of the corporation prior to the declaration of the dividend. For the reasons we have stated, we do not believe this fact to be material. But even if it be a factor to be considered, it is not, as the court below concluded, a sufficient reason for distinguishing between dividend rights and the rights to interest and rents. From a practical standpoint, as Judge Learned Hand pointed out (R. 35), "investors do not think of the income from their securities as differing, because they have separately enforceable rights in the case of debts, leases, etc., and none in the case of shares of stock; they think of all as interchangeably income from investments." In view of this, it may fairly be assumed that Congress intended to treat all income rights derived from investments in securities in the same manner. And since, as we have shown,

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and seems difficult to reconcile with the remainder of the argument of these petitioners. Throughout the rest of their brief, the argument is that only capital assets are to be included under Section 302 (j), that income, by definition, is not a return of capital, and that, therefore, a right to receive income is not a capital asset. This argument is just as applicable to extraordinary as to ordinary dividends, for all are equally income to the stockholder. *Lynch* v. *Hornby*, 247 U. S. 339. It would seem, therefore, that these petitioners' recognition of the failure of their argument with respect to extraordinary dividends is a recognition of the fallacy of their entire approach to the case.

the statute plainly covers the rights to interest and rents, it should likewise be construed to comprehend the right to dividends.

6. The Regulation is in Accord with the Congressional Purpose as Shown by the Legislative History of the Statute

The legislative history of Section 302 (j) shows that its enactment was motivated by a desire to relieve against undue hardship resulting from a decline in the market value of the assets in an estate. See H. Rep. No. 1681, 74th Cong., 1st Sess., p. 9; S. Rep. No. 1240, 74th Cong., 1st Sess., p. 9. Both before and during the consideration of the 1935 Act, it was several times pointed out to Congress that, because of the depression, many estates had depreciated greatly in value, some more than 60%, during the period necessary for administration and that in such cases it was unfair to base the estate tax on values which existed only at the date of death and which did not represent the value of the assets available for distribution.[10] Different suggestions were advanced to remedy this situation;[11] the method ultimately adopted in the 1935

[10] See H. Rep. No. 708, 72d Cong., 1st Sess., pp. 50–51; Reports to the Joint Committee on Internal Revenue Taxation, Federal and State Death Taxes (1933), pp. 135, 137, 164–165, 254, 255; Hearings before the House Committee on Ways and Means on Proposed Taxation of Individual and Corporate Incomes, Inheritances and Gifts, 74th Cong., 1st Sess., pp. 134–135, 136–138; Hearings before the Senate Finance Committee on H. R. 8974, 74th Cong., 1st Sess., pp. 204–207, 281, 282.

[11] Apparently the first proposal for the alleviation of the hardship caused by a shrinkage in values was contained in

Act was worked out by the Conference Committee. See H. Rep. 1885, 74th Cong., 1st Sess., pp. 10–11.

Section 810 of H. R. 10236, 72d Cong., 1st Sess. (1932), as reported to the House, which provided that, at the option of the executor, the tax payable should be that proportion of the tax which would have been payable on the values as of the date of death as the value of the net estate 18 months after death bears to the value of the estate at death. See H. Rep. No. 708, 72d Cong., 1st Sess., pp. 50–51. Under this proposal, it would seem plain that income to the estate during the 18-month period would be included in the optional valuation. The proposal, as amended on the floor of the House (75 Cong. Rec., Part 7, p. 7322), was stricken out by the Senate Finance Committee (S. Rep. No. 665, 72d Cong., 1st Sess., p. 54) and was again defeated on the floor of the Senate because of the serious effect it would have on the revenues (75 Cong. Rec., Part 10, p. 11385). The Senate views prevailed. H. Rep. No. 1492, 72d Cong., 1st Sess., p. 27 (Amendment No. 251).

The next proposal was made in a 1933 report to the Joint Committee on Internal Revenue Taxation on Federal and State Death Taxes. This report described in detail the situation caused by a change in property values (pp. 135–136, 137–138) and suggested a plan for the taxation of depreciated estates (pp. 164–165, 254–255). This plan, which was introduced in the record of the hearings before the House Committee considering the 1935 Act (see House Hearings, *supra*, note 10, pp. 136–138), provided for determining the tax rate on the basis of the values existing at the date of death and applying this rate to the value of the estate at the time of its distribution. Under this plan, it seems clear that income received by the estate during the period before distribution would be included in the value of the gross estate (see p. 135 of the report).

The Revenue Bill of 1935, as passed by the House, took care of the situation in a different manner. Designed as an inheritance tax to be imposed in addition to the existing estate tax, it provided for taxation of the beneficial interests

At every stage of the legislative process, however, the emphasis was on the need for allowing the

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transferred to each beneficiary and further provided that the total gross value of such beneficial interests was to be determined as of the date of the decedent's death (Section 204 (a)). By Section 205 (a) (7), however, a deduction was allowed from gross value to the extent of "The net shrinkage in value of the total beneficial interests of the beneficiary arising solely from the difference in value of assets of the decedent's estate on the date of death and the value of such assets one year after the decedent's death (or date of sale or exchange in the case of assets sold or exchanged during such period), but only to the extent that such shrinkage is not covered by any other deduction under this subsection."

At the hearings on the bill before the Senate Committee on Finance, Robert H. Jackson, then Assistant General Counsel of the Treasury, suggested that the House bill presented serious administrative difficulties because it required two valuations to be made. Senate Hearings, *supra*, note 7, pp. 204–206. He suggested that the House provision might be replaced by a deduction from the value on the date of death limited to the amount of the loss sustained during the period of administration through the sale of any assets. (*Id.*) The Senate, however, did not adopt this suggestion. It substituted increased estate tax rates in place of the inheritance tax provided for by the House bill and in Section 202 provided for a deduction from gross estate equal to "The net shrinkage in value of assets arising solely from the difference in the aggregate value of assets forming part of the decedent's gross estate on the date of death and the aggregate value of such assets one year after the decedent's death (or date of sale or exchange by the executor in the case of assets sold or exchanged during such period) but only to the extent that such shrinkage is not covered by any other deduction under this subdivision".

The present provisions of the law were worked out in conference, probably to alleviate the difficulties, suggested by Mr. Jackson, which would be caused under the Senate and House bills because of the necessity for two valuations.

executor to value the estate at what it was actually worth when it became available for distribution rather than at the unrealizable values which existed at the time of the decedent's death.[12]

The relief afforded by Section 302 (j) must be measured by the hardship it was designed to alleviate—the imposition of an estate tax based on values which did not properly reflect the value of the assets actually available for distribution. Alleviation of that hardship obviously called for no more than disregarding those values which, at the time of distribution, were no longer accessible; it neither required nor justified disregarding values which were in fact accessible. As the court below pointed out (R. 35), if executors "are not to be assessed upon what is practically beyond their

[12] See House Hearings, *supra*, note 10, p. 137; Senate Hearings, *supra*, note 10, pp. 204–207, 281-282; H. Rep. No. 708, 72d Cong., 1st Sess., pp. 50–51; S. Rep. No. 1240, 74th Cong., 1st Sess., p. 9, where the Senate Committee stated its understanding that the deduction for shrinkage in value was to be "confined to the shrinkage which could be shown to exist by taking the difference between the aggregate value of *all* assets at the date of death and the aggregate value of *all* assets 1 year after death" (italics supplied); H. Rep. No. 1681, 74th Cong., 1st Sess., p. 9, where the House Ways and Means Committee stated: "To prevent any *undue* hardship arising from a decline in value after the date of death, a *special* deduction is allowed for *net* shrinkage, based upon the difference between the value of assets on the date of death and 1 year thereafter * * *" (italics supplied); 79 Cong. Rec., Part 13, p. 14632; Reports to the Joint Committee on Internal Revenue Taxation, Federal and State Death Taxes (1933), pp. 135, 137, 164–165, 254–255.

reach they should certainly be compelled to accept in its stead the total of what is practically within it."

The point is well illustrated by the example given in the Regulations, which is set out in the margin.[13] Under petitioner's construction of the statute the only amounts to be included in the gross estate under the optional valuation method are real estate, $30,000; bonds sold, $59,400; corporate stock distributed, $100,000; bonds matured, $12,000; and corporate stock not disposed of, $50,000—a total of $251,400, plus $1,380 interest accrued at the date

[13] The Regulations (*infra*, pp. 66–75) give the following example of the operation of Section 302 (j):

Description	Valuation date	Value at valuation date	Value at date of death
Improved real estate—not disposed of within year following decedent's death	Dec. 1, 1936	$30,000	$35,000
Rents accrued but unpaid under lease antedating decedent's death	Dec. 1, 1936	900	500
Rent paid Jan. 1, 1936	Jan. 1, 1936	600	
Bonds sold June 1, 1936	June 1, 1936	59,400	60,000
Interest accrued and unpaid thereon	June 1, 1936	400	400
Interest paid Apr. 1, 1936	Apr. 1, 1936	1,200	
Corporate stock—distributed to legatee Nov. 1, 1936	Nov. 1, 1936	100,000	200,000
Cash dividend paid upon such stock Aug. 1, 1936	Aug. 1, 1936	100,000	
Bonds matured and paid Oct. 1, 1936	Oct. 1, 1936	12,000	12,000
Interest accrued			80
Interest paid at maturity	Oct. 1, 1936	240	
Interest paid Apr. 1, 1936	Apr. 1, 1936	240	
Corporate stock—not disposed of within year following decedent's death, and upon which no dividend was paid in that period	Dec. 1, 1936	50,000	100,000
Total value of gross estate pursuant to the election		354,980	
Total value of gross estate as of date of decedent's death			407,980

of death. Yet, as of one year after death, the estate had available over $100,000 additional in the form of dividend payments and interest and rent receipts and accruals. That amount was available for payment of the estate tax and for distribution to the beneficiaries. Therefore, to include that amount in the measure of the value of the gross estate would not in any way contravene the Congressional purpose of avoiding "confiscation of estates due to a sudden decline in market values." See S. Rep. No. 240, 74th Cong., 1st Sess., p. 9. On the contrary, to the extent of the income received or accrued, the decline in the market value of the securities is offset and to that extent, therefore, no relief is necessary. Indeed, it is not difficult to conceive of a situation in which an estate would actually have more at the end of the one-year period, because of income receipts and accruals, than it had at the date of death, despite a decline in market prices, and yet under petitioner's contention it would be relieved of estate tax to the extent of the market decline. Such a case would present the anomaly of an extension of tax relief to a taxpayer whose ability to pay the estate tax had actually been increased.

Petitioner places great reliance on the fact that in the Conference Committee report on the Revenue Bill of 1935 (H. Rep. N. 1885, 74th Cong., 1st Sess., p. 11) an example of the operation of

Section 302 (j) was given,[14] in which no mention was made of any interest, rents, or dividends received during the year after death. But the example also contains no mention of any interest or rents accrued to the date of death, although such accrued income is admittedly part of the value of the gross estate as of the date of death. Consequently, all that the example indicates is that the draftsmen of the report either completely overlooked the problem created by the receipt or accrual of interest, rents, and dividends, or else that they believed that the inclusion of such income in the example was unnecessary for purposes of the point they were seeking to make.

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[14] The report stated (pp. 10–11):

"A decedent dies owning real estate of the value of $100,000, corporate stock of the value of $60,000, bonds of the value of $20,000, foreign government bonds maturing 9 months after date of death of a face value of $10,000, but of a value of $9,550, and cash amounting to $5,000. These values are as of the date of death. The gross estate at date of death amounted, therefore, to $194,550. The decedent had debts of $15,000 and the administration expenses were $25,000, which debts and expenses were promptly paid by the executor. The value of the net estate as of date of death was, therefore (after taking off the specific exemption), $114,550. Six months after the decedent's death the executor distributed the bonds to a legatee under the will, at which time they were worth $18,000, and he sold all the corporate stock owned by the decedent for a fair market value of $50,000 in order to raise cash to pay the debts and expenses. The foreign bonds were paid in full at maturity. During the first year after the decedent's death the value of his real estate appreciated $5,000. The executor elects to

Petitioner's brief makes no mention of the fact that the enactment of the Revenue Act of 1935 was motivated by the need for greatly increased revenues, and that it provided for a very substantial increase in the estate-tax rates as well as for a reduction in the amount of the specific exemption allowed.[15] Certainly it is highly unreasonable to assume that in the same measure by which Congress sought to raise large additional sums for the federal Treasury, it also intended to grant to certain taxpayers a windfall of millions of dollars by

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take advantage of the new provision of the bill. The value will be arrived at in this way:

Assets:		*Value*
Real estate (as of 1 year after death)		$105,000
Corporate stock (as of date of sale)		50,000
Bonds (as of date of distribution)		18,000
Foreign bonds (as of date of disposition, i. e., maturity)		10,000
Cash		5,000
Gross estate		188,000
Deduct:		
Debts	$15,000	
Administration expenses	25,000	
Specific exemption	40,000	
		80,000
Net estate		108,000"

[15] The Act was passed in response to a message of the President, in which he strongly urged increased taxation upon the "transmission from generation to generation of vast fortunes by will, inheritance, or gift", his specific recommendation being the enactment of an inheritance tax in addition to the then existing estate tax. See H. Rep. No. 1681, 74th Cong., 1st Sess., pp. 1–4; S. Rep. No. 1240, 74th Cong., 1st Sess., pp. 1–4. The House adopted this recommendation, but the Senate, whose views prevailed, substituted increased estate-tax rates in lieu of the additional inheritance tax.

giving them, in a relief provision, a tax reduction unrelated to the need sought to be relieved. Only the most specific statutory language could justify attributing to Congress any such caprice.

7. A Provision of a Tax Statute Granting a Special Privilege Is To Be Strictly Construed

Section 302 (j) provides executors with a valuable privilege enabling them, in many cases, substantially to reduce the amount of the estate tax which would otherwise be payable. A provision granting such a special privilege, like provisions granting exemptions, deductions, or other favored treatment, must be strictly construed. See e. g., *United States* v. *Stewart,* No. 13, present Term, decided November 12, 1940; *Helvering* v. *Northwest Steel Rolling Mills, Inc.,* No. 121, present Term, decided November 12, 1940; *Helvering* v. *Inter-Mountain Life Ins. Co.,* 294 U. S. 686, 689–690; *New Colonial Ice Co.* v. *Helvering,* 292 U. S. 435, 440; *Brown* v. *Helvering,* 291 U. S. 193, 199; *Deputy* v. *DuPont,* 308 U. S. 488, 493; *White* v. *United States,* 305 U. S. 281, 292; *Chicago Theological Seminary* v. *Illinois,* 188 U. S. 662, 672. These decisions, it is true, relate to exemptions or deductions, but their rationale is fully applicable to such a special privilege as that granted by Section 302 (j). See *Commissioner* v. *Manus Muller & Co.,* 79 F. (2d) 19, 20 (C. C. A. 2d). The basis of the rule would appear to be a presumption that the legislative authority does not intend to aban-

don any source of revenue unless that intention be clearly expressed, and that consequently anyone claiming favored treatment must bear the burden of showing that his claim comes strictly within the letter of the statute. See Paul & Mertens, *Law of Federal Income Taxation*, Vol. I, Sec. 3.30. Certainly in the light of the arguments advanced in the foregoing pages, the most that petitioner here may claim is that the interpretation of Section 302 (j) is a matter of doubt. If there be any such doubt, then, under the authorities cited, it must be resolved against the taxpayer.

Petitioner derives no help from the principle upon which he relies (Br. 34) that a relief measure should "be construed liberally in favor of the taxpayers to give the relief it was intended to provide." *Bonwit Teller & Co.* v. *United States*, 283 U. S. 258, 263; *Burnet* v. *Marston*, 57 F. (2d) 611, 612 (App. D. C.). As we have shown, all relief necessary to meet the situation which prompted enactment of Section 302 (j) is accorded by the Regulation; the question here is not whether the taxpayer should secure such relief, but whether in addition thereto, he should secure an unnecessary and unjustified windfall. The authorities cited by petitioner do not support his position on that question.[16]

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[16] *Helvering* v. *Bliss*, 293 U. S. 144, 150–151, cited by petitioners in Nos. 510 and 511, is likewise not in point. There the Court held that a provision for charitable deductions,

8. The Contentions Advanced by the Petitioner in This Case and by the Petitioners in the Abendroth and Blacque Cases Do Not Establish the Invalidity of the Regulation

For purposes of convenience we shall discuss in this portion of the brief not only the contentions advanced by the petitioner in this case but also the contentions advanced by the petitioners in the *Abendroth* and *Blacque* cases (Nos. 510 and 511, present Term), with which this case is to be argued, the petitioners in all three cases being referred to collectively as "the taxpayers." Most of those contentions have been answered in the preceding sections of this brief. Various miscellaneous arguments advanced, however, require further brief analysis.

A. *The Regulation covers only the rights to interest, rents, dividends, and royalties.*—In both of their briefs the taxpayers emphasize what they conceive to be the difficulty of applying the theory of the Regulation to types of income not involved in any of the present cases, such as the progeny of livestock owned by the decedent which are born after decedent's death, crops grown after death upon decedent's land, and rents collected under a lease made by the executor. The simple answer to the taxpayer's difficulty is that the Regulation does not cover this type of case.

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since it was "begotten from motives of public policy," was not to be narrowly construed. There is no comparable policy applicable to Section 302 (j).

The Regulation (pp. 69–70, *infra*) first discusses interest-bearing obligations, such as bonds and notes; it then provides that "Like rules will govern, *so far as applicable,* when any other *obligation* is involved, as, for example, one calling for the payment of rent or a royalty" (italics supplied). Finally it takes up dividends on stock and payments on a judgment. Nowhere, however, does it provide for the inclusion of the progeny of livestock, crops grown on decedent's land after his death, or rental payments under a lease made by the executor. Indeed, the latter type of income, at least, seems plainly to be ruled out since the provision for the inclusion of the right to rent states that "in the case of rent, if the realty and the obligation to pay the rent reserved were parts of the gross estate at the time of decedent's death", then the valuation date of any rent paid during the year after death is to be the date of payment.

The Regulation has been so construed by the Bureau of Internal Revenue. The Chief Counsel of the Bureau has informed us that it is the policy and the practice of the Bureau not to include as part of decedent's gross estate, under the optional valuation method, the value of crops planted after the date of decedent's death, livestock born after that date, or rents under leases made by the decedent's executor, and that if any of these items have been included in any case, such inclusion is due solely to error on the part of the examining officer.

In these circumstances, it is unnecessary to consider whether the statute is susceptible of a different construction with respect to these items than that placed upon it by the Bureau. It may be that the Regulation does not go far enough, but the only question here is its validity within the sphere in which it operates. And certainly there is ample ground for the distinction which the Bureau has drawn between the specific rights of the decedent, as against particular persons or corporations, to interest, rents, dividends, and royalty payments, on the one hand—rights which existed at the time of decedent's death and which entered into the value of his gross estate—and the general "right" of the decedent, as against the whole world, to enjoy whatever income his efforts may produce from the property which he owns. In the latter type of situation, no income can be enjoyed unless specific action is taken with respect to the property owned, i. e., planting crops, breeding livestock, executing leases; the owner of stocks, bonds, or real estate subject to a lease, on the other hand, has a presently existing right to income which may be enjoyed without further action on his part. Consequently, the taxpayers' contention that the general "right" to the enjoyment of any future income, which is inherent in property ownership, is not of itself a property right, has no bearing on the validity of the Regulation in its application to the specific rights to interest, rents, and dividends.

It is true that under the statute, as construed by the Regulation, some income realized by the estate during the year after death will be included in the measure of the value of the gross estate and some will not. This result, however, is directly attributable to the character of the property of which decedent died the owner, which the statute makes determinative. And it is to be noted that a similar lack of symmetry in the treatment of income is inherent in the taxpayers' construction of the statute. It is not disputed that if a security owned by the decedent is sold by his executor during the year after death for more than its value at the date of death, the resulting capital gain, which is taxable income to the estate, must also be included in the value of the gross estate (Sec. 113 (a) (5)). Clearly, therefore, the taxpayers' theory, no less than the theory embodied in the Regulation, requires that some income be included and some excluded. The lack of consistency under the taxpayers' theory, however, goes much further. It means, as we have pointed out, the drawing of an illogical distinction between increases in the value of an estate due to accumulated corporate earnings, which are reflected in an increased value for the stock, and those due to distributed corporate earnings (see pp. 38–39, *supra*); it also means the drawing of an illogical distinction between increases in the value of United States Savings Bonds, for example, and increases in value of comparable interest-bearing bonds. In these circum-

stances, lack of symmetry in the treatment of income under the Regulation is certainly no reason for rejecting the Regulation in favor of the taxpayers' construction of the statute.

B. *No question of double taxation is involved.*—The suggestion of the petitioner in this case (Br. 16) and the contention of the petitioners in the *Abendroth* and *Blacque* cases (Br. 17), based on the presumption against double taxation (see *United States* v. *Supple Biddle Co.*, 265 U. S. 189; *Bull* v. *United States*, 295 U. S. 247), shows a misconception of the theory of the Regulation. The interest, rents and dividends received during the year after death, which are taxable income of the estate, are not subject under the Regulation to an estate tax. The subject of the estate tax is rather the right to the interest, rents and dividends, and the amount of the interest, rents and dividends received is used simply as a measure of the value of the right. That this is not double taxation is clearly pointed out in *Bull* v. *United States, supra,* a decision upon which the taxpayers strongly rely. There the decedent was a member of a personal service partnership having no invested capital. Under the partnership agreement the surviving partners had a right, with the permission of decedent's executor, to continue the partnership for a year after the decedent's death, in which case the estate was to share in the profits and losses in the same manner as decedent would have if living. The partnership

was continued and a share of the profits paid to the estate. The Commissioner included these profits as part of decedent's gross estate as of the date of death. In holding this action to be erroneous, in part because it involved double taxation, this Court stated:

> While * * * the same sum may in different aspects be used for the computation of both an income and an estate tax, this fact will not here serve to justify the Commissioner's rulings. They were inconsistent. *The identical money,—not a right to receive the amount, on the one hand, and actual receipt resulting from that right on the other,—was the basis of two assessments.* [Italics supplied.]

The situation here is analogous to the treatment which is always accorded income accrued to the date of decedent's death. Such accrued income is taxable as income to the decedent; it is also included as part of his gross estate as of the date of death. Since that is not considered objectionable double taxation (see *Bull* v. *United States, supra,* at 255), there is no reason to consider objectionable the comparable inclusion of income rights under Section 302 (j). It should be noted that, even under the taxpayers' construction of Section 302 (j), the statute would in some cases result in the imposition of both an income and an estate tax, since any capital gains made during the year after death would be both income and part of the gross estate.

But even apart from these considerations, it seems entirely clear, as the court below pointed out (R. 35–36), that the presumption against double taxation is not applicable when such double taxation as may be involved results from an election made by the executor. Computation of gross estate under the optional valuation method is a privilege; if the taxpayer wishes not to be subject to both estate and income taxes, he "may always escape by accepting an assessment as of the time of death" (R. 36).

C. *Only net income is used to measure the value of decedent's income rights.*—The taxpayers also question the propriety of the Regulation because, they assert, gross income is used to measure the value of decedent's income rights without any deduction for operating costs. This contention relates primarily to the propriety of the inclusion of rents as a measure of value, since there are normally no operating costs in connection with bonds and stocks. Even as regards rent, the contention would not seem available to the taxpayers, since the record in the case is silent as to whether the estate had any operating costs in connection with decedent's leased realty, and no leased realty at all is involved in the *Abendroth* and *Blacque* cases.

But in any event, the contention is without merit. The property to be valued is the decedent's right to receive income; the value of that right may, of

course, properly be measured only by the net income received. Consequently, although the Regulation is silent on the question, the Bureau of Internal Revenue, so we are informed, has made it its policy to include in the measure of value only the net income received by the executor.[17] Thus, if the decedent at his death owned real property subject to a lease, the value of his right to rent is to be measured by the gross rental less operating expenses, which would include maintenance and repairs, local taxes, management and brokerage fees, and the like. Cf. *Gude* v. *Commissioner,* unreported memorandum opinion of the Board of Tax Appeals, decided June 17, 1940, appeal to the Circuit Court of Appeals for the Fourth Circuit pending, No. 4684.

D. *The authorities relied upon by the taxpayers are distinguishable.*—The taxpayers place their principal reliance on *Bull* v. *United States,* 295 U. S. 247, *United States* v. *Safety Car Heating Co.,* 297 U. S. 88, *Irwin* v. *Gavit,* 268 U. S. 161, *Koshland* v. *Helvering,* 298 U. S. 441, and *Lynch* v. *Hornby,* 247 U. S. 339. All of these decisions are readily distinguishable.

In the *Bull* case, as stated above (*supra,* p. 56), the Commissioner included in decedent's gross estate as of the date of death the profits which had been earned after decedent's death by a personal service partnership without invested capital.

[17] The Bureau informs us that, although there may have been instances to the contrary, such instances do not reflect the general policy and practice of the Bureau.

These profits had been paid to the estate pursuant to a provision of the partnership agreement that the estate was to share in the partnership profits and losses in the same manner as though the decedent were alive. In holding the Commissioner's action to be erroneous, the Court pointed out, first, that the Commissioner had levied the tax on the profits themselves and not on decedent's right to the profits, and second, that the right of a partner to share in the earnings of a personal service partnership which has no capital and owns no tangible property cannot be considered a valuable capital asset. This holding, of course, has no application here. The only right which the members of such a partnership have is the right to whatever profits their collective efforts in the future may earn. This right is of dubious value, since each partner is also liable for his share of the losses; in any event, since enjoyment of the right is dependent upon future services to be rendered by each of the partners it cannot fairly be characterized as a present property right. The rights to interest, rents, and dividends, on the other hand, have a present value and their realization is not dependent upon the rendition of future services; they may, therefore, as we have shown, properly be considered as part of the decedent's gross estate.

The *Safety Car Heating Co.* case, *supra,* is even further afield. The question there was as to the date when profits recovered on a claim of patent

infringement were income realized by the patentee. Some of the acts of infringement took place prior to March 1, 1913, but as of that date the claim was contested and no collection was made until 1925. The patentee urged that any profits received in 1925 because of infringements which had taken place prior to 1913 should be construed as income accrued on March 1, 1913. The Court, however, held otherwise, pointing out that on March 1, 1913, both the existence and extent of petitioner's right was so contingent and indefinite as to lack the quality of accrued income, and that the proceeds of the claim must, therefore, be considered income when realized. The decision is inapplicable here for two reasons. The first is the obvious difference between an indefinite and contested claim for patent infringement and a definite contractual right to interest, rents, and dividends; the second is that the *Safety Car Heating Co.* case related to the question of when income is realized and not to the question of whether a specific right to future income is a presently existing property right. The contention here is not, as it was in the *Safety Car Heating Co.* case, that the interest, rents, and dividends received by the estate constituted income accrued prior to the decedent's death and consequently were not income to the estate. The contention is rather that at his death decedent owned a right to that income and that that right was property within the meaning of Section 302 (j).

Insofar as the *Safety Car Heating Co.* decision has any bearing on that question, it supports our position, because the Court there recognized that the contested claim might properly be regarded as "property," although not as "property that has been transmuted into capital." 297 U. S. at 97.

Nor is there anything opposed to our position in *Irwin* v. *Gavit, supra,* in *Koshland* v. *Helvering, supra,* or in *Lynch* v. *Hornby, supra.* In the *Gavit* case the holding was that income received by a beneficiary of a testamentary trust is taxable as income to him and is not exempt as property acquired by bequest. In the *Koshland* case, the holding was that a dividend of common stock paid to holders of preferred stock constitute income rather than a return of capital. In *Lynch* v. *Hornby, supra,* the holding was that corporate dividends are taxable income to the stockholder, even though extraordinary in amount and to a large extent derived from surplus accumulated prior to March 1, 1913. These cases simply stand for the proposition, which we do not dispute, that the interest, rents, and dividends received by the petitioner in this case were taxable income to the estate. They do not hold or in any way suggest that decedent's rights to that income, owned by him at the date of his death, were not property rights within the meaning of Section 302 (j).

CONCLUSION

The decision below should be affirmed.

Respectfully submitted.

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APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9, as amended:

SEC. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

(a) To the extent of the interest therein of the decedent at the time of his death;

* * * * *

(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. * * *

* * * * *

(j) If the executor so elects upon his return (if filed within the time prescribed by law or prescribed by the Commissioner in pursuance of law), the value of the gross estate shall be determined by valuing all the property included therein on the date of the decedent's death as of the date one year after the decedent's death, except that (1) property included in the gross estate on the date of death and, within one year after the decedent's death, distributed by the executor (or, in the case of property included in the gross estate under subdivision (c), (d), or (f) of this section, distributed by the trustee under the instrument of transfer), or sold, exchanged, or otherwise disposed of,

shall be included at its value as of the time of such distribution, sale, exchange, or other disposition, whichever first occurs, instead of its value as of the date one year after the decedent's death, and (2) any interest or estate which is affected by mere lapse of time shall be included at its value as of the time of death (instead of the later date) with adjustment for any difference in its value as of the later date not due to mere lapse of time. No deduction under this title of any item shall be allowed if allowance for such item is in effect given by the valuation under this subdivision. Wherever in any other subdivision or section of this title or in Title II of the Revenue Act of 1932, reference is made to the value of property at the time of the decedent's death, such reference shall be deemed to refer to the value of such property used in determining the value of the gross estate. In case of an election made by the executor under this subdivision, then for the purposes of the deduction under section 303 (a) (3) or section 303 (b) (3), any bequest, legacy, devise, or transfer enumerated therein shall be valued as of the date of decedent's death with adjustment for any difference in value (not due to mere lapse of time or the occurrence or nonoccurrence of a contingency) of the property as of the date one year after the decedent's death (substituting the date of sale or exchange in the case of property sold or exchanged during such one-year period). [Added by Sec. 202 (a) of the Revenue Act of 1935, C. 829, 49 Stat. 1014.]

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SEC. 303. For the purpose of the tax the value of the net estate shall be determined—

(a) In the case of a resident, by deducting from the value of the gross estate—

* * * * *

(2) An amount equal to the value of any property (A) forming a part of the gross estate situated in the United States of any person who died within five years prior to the death of the decedent, or (B) transferred to the decedent by gift within five years prior to his death, where such property can be identified as having been received by the decedent from such donor by gift or from such prior decedent by gift, bequest, devise, or inheritance, or which can be identified as having been acquired in exchange for property so received. This deduction shall be allowed only where a gift tax imposed under the Revenue Act of 1924, or an estate tax imposed under this or any prior Act of Congress was paid by or on behalf of the donor or the estate of such prior decedent as the case may be, and only in the amount of the value placed by the Commissioner on such property in determining the value of the gift or the gross estate of such prior decedent, and only to the extent that the value of such property is included in the decedent's gross estate and not deducted under paragraph (1) or (3) of this subdivision;

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Treasury Regulations 80 (1937 Ed.):

ART. 11. *Optional valuation date.*—In general, the object of subdivision (j) of section 302 is to make provision whereby the amount of tax otherwise payable may be lessened when, within the year following the decedent's death, the gross estate has suffered a shrinkage in its aggregate value.

If the decedent died after August 30,

1935, the executor may, by an election upon his return, Form 706, if filed within the time prescribed by law or prescribed by the Commissioner in pursuance of law, have the property which was included in the gross estate on the date of the decedent's death valued as of the applicable dates, as follows:

(1) Any property distributed, sold, exchanged, or otherwise disposed of within one year after the decedent's death, valued as of the date of such distribution, sale, exchange, or other disposition, whichever first occurs;

(2) Any property not distributed, sold, exchanged, or otherwise disposed of within such 1-year period, valued as of the date one year after the date of the decedent's death;

(3) Any property, interest, or estate which is affected by mere lapse of time, valued as of the date of decedent's death; except that an adjustment is to be made for any difference in its value, not due to such lapse of time, as of the date one year after the date of decedent's death, or as of the date of its distribution, sale, exchange, or other disposition, whichever date first occurs.

Property "distributed" is limited to distributions thereof by the executor, or by the trustee in the case of property included in the gross estate under subdivision (c), (d), or (f) of section 302, as amended. Distribution may be effected by the entry of the order or decree of distribution, or, if there is no such order or decree, by the segregation or separation of the property from the estate or the trust, or by the actual paying over or delivery of the property to the person entitled thereto by the will, or under the law, or by the terms of the trust.

The sale, exchange, or other disposition, to which subdivision (j) refers, may be one made by the executor, or by the trustee of property included in the gross estate under subdivision (c), (d), or (f) of section 302, as amended, or by any other person to whom the property had not been distributed by the executor or by such a trustee, or to whom it had not passed from the gross estate as the result of a sale, exchange, or other disposition thereof, as, for example, a sale, exchange, or other disposition by an heir, devisee, donee or grantee to whom the decedent in his lifetime transferred the property, or by the survivor of the decedent if the property had been held by them subject to the right of survivorship.

Property, in the case of a sale, exchange, or other disposition thereof within the 1-year period, is to be valued as of the date when it ceases to form a part of the gross estate, that is, the date when the title passes as the result of its sale, exchange, or other disposition. The terms "distributed," "sold," "exchanged," "or otherwise disposed of" comprehend all possible ways by which property may be separated or passed from the gross estate. Thus, money on hand at decedent's death which is thereafter used in the payment of the funeral expenses, or in settlement of claims against the estate, or is invested, falls within the term "otherwise disposed of."

The property to be valued as of one year after the date of decedent's death, or as of date of decedent's death, or as of some intermediate date, is the property included in the gross estate on the date of the decedent's death. As property and its value are separate and distinct, the former denoting legal

rights, the latter the monetary measure of such rights, and as subdivision (j) treats of the two separately, it will be necessary in every case first to determine what property constituted the gross estate at decedent's death. Subdivisions of section 302, as amended, other than subdivision (j), supply the information necessary to that determination, subdivision (j) being, in the main, confined to the date or dates as at which the value is to be ascertained.

Interest-bearing obligations, such as bonds and notes, embody two promises, one to pay principal and the other to pay interest, and both promises are a part of the gross estate at the death of the decedent, if the obligation was then owned by him, or had been previously so transferred by him, or at his death there was vested in him any such right or power in or with respect to the obligation as to bring it within any of the other subdivisions of section 302, as amended. If the valuation date is that of decedent's death, the principal of the obligation and interest then accrued and unpaid thereon are to be valued as of that date. If the valuation date is subsequent to death, the principal and interest then accrued and unpaid are to be valued as of that date. The valuation date of any part payment of principal or of any installment of interest, made between decedent's death and the date as at which the obligation is to be valued, will be the date of such payment. Like rules will govern, so far as applicable, when any other obligation is involved, as, for example, one calling for the payment of rent or a royalty. Thus, in the case of rent, if the realty and the obligation to pay the rent reserved were parts of the gross estate at the time of

decedent's death, the value of the former must be determined as of the applicable valuation date, and also the value of the rent then accrued and unpaid reserved by the latter. The valuation date of any rent paid in the interim pursuant to the rental obligation will be the date of its payment.

As in the case of bonds and notes, the interest accrued and unpaid upon a judgment on the date as of which the judgment is to be valued is to be included in the valuation. The valuation date of any part payment of the judgment, or of any interest thereon (without regard to whether earned before or after decedent's death), made between decedent's death and the date as of which the judgment is to be valued, will be the date of such payment.

When corporate stock is a part of the gross estate at decedent's death, and a dividend in partial liquidation is thereafter paid on or before the date as of which the stock is to be valued, the valuation date of such dividend will be the date of its payment. Similarly, a dividend paid within the same period out of earnings, whether the earnings are made or accumulated prior or subsequent to decedent's death, will be valued as of the date of its payment. Earnings of the corporation neither declared as a dividend nor paid between decedent's death and the valuation date of the stock, will be reflected in the value of the stock. But a dividend declared prior to the valuation date of the stock and payable subsequent thereto will not be so reflected if the stock is selling "ex dividend" on such valuation date, but is to be valued as of that date.

Differing from payments of principal and interest in the case of bonds and notes, those

made upon a judgment are not pursuant to a promise but to an obligation imposed by law which obligation, in its totality, is a part of the gross estate at decedent's death if coming within any of the other subdivisions of section 302, as amended. So, too, liquidating dividends and dividends paid from earnings are not pursuant to a promise but are referable to legal rights inherent in stock ownership.

By way of illustrating the operation of subdivision (j), there is given the following example in which the death of the decedent will be taken to have occurred December 1, 1935:

Description	Valuation date	Value at valuation date	Value at date of death
Improved real estate—not disposed of within year following decedent's death	Dec. 1, 1936	$30,000	$35,000
Rents accrued but unpaid under lease antedating decedent's death	Dec. 1, 1936	900	500
Rent paid Jan. 1, 1936	Jan. 1, 1936	600	.....
Bonds sold June 1, 1936	June 1, 1936	59,400	60,000
Interest accrued and unpaid thereon	June 1, 1936	400	400
Interest paid Apr. 1, 1936	Apr. 1, 1936	1,200	.....
Corporate stock—distributed to legatee Nov. 1, 1936	Nov. 1, 1936	100,000	200,000
Cash dividend paid upon such stock Aug. 1, 1936	Aug. 1, 1936	100,000	.....
Bonds matured and paid Oct. 1, 1936	Oct. 1, 1936	12,000	12,000
Interest accrued			80
Interest paid at maturity	Oct. 1, 1936	240	.....
Interest paid Apr. 1, 1936	Apr. 1, 1936	240	.....
Corporate stock—not disposed of within year following decedent's death, and upon which no dividend was paid in that period	Dec. 1, 1936	50,000	100,000
Total value of gross estate pursuant to the election	.....	354,980	.....
Total value of gross estate as of date of decedent's death	.....	.....	407,980

Properties, interests, or estates which are affected by mere lapse of time include patents, estates for the life of a person other than the decedent, remainders, reversions,

and other like properties, interests, or estates. The phrase "affected by mere lapse of time" has no reference to obligations for the payment of money, whether or not interest-bearing, the value of which changes with the passing of time. However, such an obligation, like any other property, may become affected by lapse of time when made the subject of a bequest or transfer which itself is creative of an interest or estate so affected.

The date of valuation of any property, interest, or estate so affected is, as prescribed in subdivision (j), the date of decedent's death, but with an adjustment to be made of the value then obtaining, which adjustment, while disregarding any later increase or decrease in value due solely to lapse of time, adds to or subtracts from the value at death any difference between that value and the value as of the date one year after decedent's death, or the applicable intermediate date, if, and to the extent that, such difference was due to a cause or causes other than lapse of time. Accordingly, in the valuation of any property, interest, or estate affected by lapse of time, the difference between its value at decedent's death and its value as of the later date must be analyzed to determine the portion of such difference attributable to other cause or causes, and that portion only is to be applied in adjusting the value as of the date of the decedent's death. If, for example, the decedent owned a patent which on the date of his death had an unexpired term of 10 years and a value of $100,000, and if the patent was sold 6 months after the decedent's death, at which time, because of the lapse of time and other causes, only $65,000 was realized therefor, the value would be determined as follows:

Value of patent on date of decedent's death		$100,000
Difference between value on date of death and date of sale ($100,000 minus $65,000)	$35,000	
Portion of such difference due to the 6 months elapsing between date of death and date of sale (one-half of 10 percent of $100,000)	5,000	
Portion of difference due to causes other than lapse of time		30,000
Adjusted value of patent		70,000

Or, to give another example, it may be supposed that the decedent was entitled to receive property which, at the time of his own death, was worth $50,000 upon the death of another person who was entitled to the income therefrom for life and who was 31 years old at the time of the decedent's death. The value at decedent's death of his remainder interest would, as explained in articles 10 (i) of these regulations, be $15,631, and if, due to economic conditions, the property declined in value and became worth $40,000 one year after the date of decedent's death, the value of the remainder interest would be determinable in the following manner:

Value of remainder interest at decedent's death ($50,000 times factor (0.31262) shown opposite age 31 in column 3 of Table A, article 10)		$15,631.00
Value of remainder interest one year after decedent's death ($40,000 times factor (0.31929) shown in Table A, for age 32)		12,771.60
Net difference due in part to decline in value of the property and in part to increase in the value of the remainder interest due to lapse of time	2,859.40	
Elimination of the increase due to lapse of time ($50,000 times the difference between the factor for age 32 and the factor for age 31, or 0.00667)	333.50	
Portion of the difference in value due to the decline in value of the property		3,192.90
Value of remainder interest at decedent's death		15,631.00
Less portion of difference not due to lapse of time		3,192.90
Adjusted value of remainder interest		12,438.10

(The amount of the adjustment may be computed more readily by multiplying the decline in the value of the property ($10,000) by the factor (0.31929) applicable to the later date.)

Deductions authorized under section 303 are limited to the extent that allowance thereof is not, in effect, given in the valuing of the gross estate. Property passing by decedent's will, or passing by a transfer made by the decedent in his lifetime (if the transfer was such as to require the property transferred to be included in the gross estate) to or for any such public, charitable, or religious uses as are described in section 303 (a) (3) or in section 303 (b) (3), is deductible at its value as of the date of the decedent's death, subject, however, to adjustment for any difference in value one year after such death, or at the date of the sale or exchange in the case of property sold or exchanged during such 1-year period. But no such adjustment may take into account any difference in value due to lapse of time or to the occurrence or nonoccurrence of a contingency.

The election is available to the executor only at the time the return is filed, and only if the return is filed within 15 months from the decedent's death, or within the period of an extension of time for filing granted under the provisions of article 68 or 69 of these regulations. The election applies to all the property included in the gross estate on the date of the decedent's death. It cannot be applied only to a portion of such property. The election, if exercised, cannot be rescinded.

In every case where the election is exercised, the return, Form 706, must set forth (1) an itemized description of all property included in the gross estate on the date of the decedent's death, together with the value of each item as of that date, (2) an itemized disclosure of all distributions, sales, exchanges, and other dispositions of any of the prop-

erty during the 1-year period after the decedent's death, together with the dates thereof, and (3) the value of each item of property determined in accordance with the provisions of subdivision (j). The amount of any income accrued and unpaid at the date of the decedent's death on each item of principal, the amount of any income collected or otherwise realized thereon after the decedent's death and prior to the date as of which the item of principal is to be valued, and the amount of any income accrued and unpaid thereon at such subsequent valuation date, shall be separately shown. All the information indicated by Form 706 must be supplied. Statements as to distributions, sales, exchanges, and other dispositions of the property within the 1-year period must be supported by evidence. If the court makes an order or decree of distribution during that period, a certified copy thereof must be submitted as part of the evidence. The Commissioner may require the submission of such additional evidence as is deemed necessary.

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